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IN THE

Supreme Court of the United States

OCTOBER TERM—1931.

No. 355.

FRANK COLLIS BOWERS, as Executor of the Estate of Frank K. Bowers, formerly United States Collector of Internal Revenue, deceased,

Petitioner,

—against—

LAWYERS MORTGAGE COMPANY,

Respondent.

BRIEF FOR RESPONDENT.

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LAWYERS MORTGAGE COMPANY,

Respondent.

BRIEF FOR RESPONDENT.

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Opinions.

The opinion of the District Court (R. 15-18) is reported in 34 F. (2d) 504. The opinion of the Circuit Court of Appeals (R. 68-73) is reported in 50 F. (2d) 104.

Jurisdiction.

Jurisdiction of this Court is by virtue of Section 240 (a) of the Judicial Code, as stated in petitioner's brief. The judgment to be reviewed was dated June 8, 1931 (R. 74). Petition for certiorari was filed on September 5, 1931 (R. 74); and the petition was granted on October 26, 1931 (R. 74).

Statement.

The statement of the question presented and of the facts in petitioner's brief is incomplete and inaccurate, because petitioner's counsel have attempted to avoid any admission that mortgage insurance is a recognized branch of insurance. Also, as a concession to the Government's position, the description of respondent's business in the stipulation and in the findings (R. 7-15; 18-26) was stated in the reverse of the logical order. The actual facts are simple.

The respondent was incorporated in New York under Article V of the Insurance Law in 1893 (R. 7, 18). Its charter authorized it to do title and mortgage insurance, as permitted by paragraph 1 of Section 170; but it has never engaged in title insurance (R. 9, 20).

In insuring mortgages, it issues a regular policy of mortgage insurance or guaranty (R. 12, 22), the form of which is in evidence as Exhibit T (R. 57-61). Under the policy, the respondent guarantees to the assured the payment of interest at a specified rate within five days after it becomes due under the mortgage insured, and payment of the principal as and when collected, but in any event within eighteen months after written demand by the assured (R. 57). The rate of interest specified in the policy is usually ½ of 1% less than the rate of interest in the mortgage insured (R. 11, 12, 22, 23). By accepting the policy, the assured appoints the respondent its agent to collect the interest and principal (R. 57-58); and the policy authorizes the respondent to retain such excess interest (*i. e.*, ½ of 1%), as the premium for its guaranty (R. 58).

Prior to 1911, mortgage insurance companies in New

York were limited to such insurance of outstanding mortgages held by others, paragraph 1 of Section 170, Article V, authorizing them only to "guarantee or insure the payment of bonds and mortgages". Respondent's charter authorized only such business (Exhibit A, Exhibit B, R. 7, 8, 18, 19); and, as the Circuit Court of Appeals pointed out (R. 69), it was respondent's sole business, prior to 1913. This elementary feature of respondent's business is still substantial in amount (R. 12, 23); and counsel for the Government conceded in the District Court that it was strictly insurance business (R. 15, 17). It has been entirely ignored by counsel for the petitioner in their brief in this Court, both in the argument and, except for the four-line statement at page 7, in the statement of facts.

The New York statute was amended by L. 1911, ch. 525, and later by L. 1913, ch. 215, so as to authorize title and mortgage insurance companies organized under paragraph 1, Section 170, Article V, to *invest in, purchase and sell,* with their guarantee, bonds and mortgages of specified classes. The respondent's certificate of incorporation was amended accordingly in December, 1913 (R. 8, 19; the amended certificate, Exhibit C, has not been printed in the record, but the complaint, at R. 2, shows the amended statement of purposes and powers, which is a paraphrase of the statute).

The statutory amendments were no doubt partly due to the fact that, as the findings show (R. 12, 22), lenders about to make loans on bond and mortgage sometimes make it a condition in advance that the respondent (or some other mortgage insurance company) will insure the mortgage, when made. The amendments authorizing such companies to invest in and sell mort-

gages, with their guarantee, enabled the companies to act in effect as clearing houses between borrowers and lenders; and the companies were also enabled, by making mortgage loans themselves, to offer to investors wishing to invest in guaranteed bonds and mortgages a wide range of choice of desirable mortgage loans which they could purchase, with insurance, directly from the mortgage insurance companies, instead of themselves having to find and make desirable loans and then have the mortgages insured.

Following such amendment, during the period now under consideration, the bulk of the respondent's business was accordingly done by making mortgage loans in its own name and selling the bonds and mortgages to investors, with its insurance, in the manner described at length in the findings (R. 10-11, 21-22). The loans were made on application (R. 10, 21), the borrower paying for the title insurance, survey and other expenses, and the respondent receiving a lending fee, including its appraisal charges (*id.*). Such lending fees (and extension fees on renewals of mortgages) were at the prevailing rates charged by other lenders (R. 13, 23-24). In occasional cases, the respondent actually acted as a clearing house, receiving from the investor in advance the money to be loaned, before the loan was actually made (R. 12, 23).

Such loans were usually for a period of five years (R. 13, 23). In disposing of them, the respondent either assigned the bond and mortgage to the purchaser in its entirety, issuing to him at the same time its regular policy of mortgage guaranty, Exhibit T (R. 21, 22), or, especially in the case of large mortgages, it assigned fractional interests or participations in the mortgage (*id.*), in which case it issued to the purchaser

a so-called "Guaranteed First Mortgage Certificate" in the form of Exhibit U (R. 61-63). This Certificate combined an assignment of an interest in the specified mortgage with a guaranty similar in terms and operation to the regular policy, Exhibit T. Since 1918, participations evidenced by such Certificates have been legal investments for executors and trustees in New York (see L. 1918, ch. 544).

In disposing of such loans, the respondent invariably issued either its regular form of policy, Exhibit T, or its Guaranteed First Mortgage Certificate, Exhibit U (R. 12, 23). In neither case did it make any profit on the sales by selling mortgages for more than face value or more than the amount actually advanced (*id.*). The primary object of the respondent in making such loans was, concededly, the sale of the bonds and mortgages, with its guaranties (*id.*). The same general method of doing business was followed by the other companies engaged in guaranteeing mortgages in New York State, except subsidiary companies not dealing with the public (R. 13, 24).

The lending and extension fees were at the prevailing rates charged by other lenders (R. 13, 31), the rates for building loans being higher on account of the constant inspection necessary (*id.; cf.,* building loan contract, Exhibit R, R. 41-52). Commencing with the year 1921, there was a marked increase in building activity in New York City and a corresponding increase in the demand for mortgage loans, especially building loans (R. 14, 32). The result was reflected in the respondent's income from lending and extension fees, which, as the Government's letter denying the claims for refund shows (Exhibit M, R. 36), gradually increased from $89,821 in 1918 to $848,543 in 1922 and $1,033,313.80 in 1923.

Statute Involved, and Question Presented.

Prior to 1921, the Revenue Acts had imposed income and capital stock taxes on all domestic corporations, except those expressly exempted; and such taxes were continued by Sections 230 and 1000, respectively, of the Revenue Act of 1921. That Act, however, placed insurance companies in a separate class by imposing special income taxes upon them, "in lieu of the taxes imposed by Sections 230 and 1000", and exempting them from the payment of capital stock taxes. The special income taxes, which were at the same rate as that for other corporations, were imposed by Section 243 on "every life insurance company" (the term "life insurance company" being defined in Section 242) and by Section 246, commencing with the year 1922, upon "every insurance company (other than a life or mutual insurance company)", there being no definition of the term "insurance company". Section 1000, subdivision (b), specifically provided that on and after July 1, 1922, the capital stock taxes imposed by that section should not apply "to any insurance company subject to the tax imposed by section 243 or 246", which is the provision involved on the present appeal. The material portions of the statute are set forth in full in Appendix A of this brief (*infra,* pp. 35-39) and are discussed in detail hereafter (*infra,* pp. 15-20). Capital stock taxes on other corporations were finally repealed by the Revenue Act of 1926 (Sec. 1200, a, repealing Title VII of the Revenue Act of 1924).

The respondent inadvertently continued to file returns and pay capital stock taxes for two years following the enactment of the Revenue Act of 1921. It then

filed claims for refund, which were denied (Exhibit W, R. 64; Exhibit M, R. 35-39); and this action was brought to recover the amounts paid. The facts were stipulated (R. 7-15); and the sole question presented to this Court is whether the Courts below were right in holding, on the stipulated facts, that the respondent was entitled to classification as an insurance company under the provisions of the Revenue Act of 1921 above referred to.

Summary of Argument.

The respondent was concededly an insurance company, under the laws of the State of New York. Its business was insurance, in the commonly accepted meaning of that term, and had been taxed as insurance under the preceding Revenue Acts. The statute was clearly intended to apply to insurance companies recognized as such under State laws, and no orderly enforcement of the statute would have been possible under any other construction, on account of the different fiscal periods covered by the income tax and the capital stock tax. There is in any event no reason for excluding the respondent from such classification.

Argument.

FIRST.

The respondent was an insurance company, under the laws of the State of New York.

It is conceded that the respondent has always been an insurance company under the laws of the State of New York. It was incorporated as such in 1893 (R. 7, 18). It has always been subject to all the provisions of the Insurance Law (R. 8, 19) and has maintained the guaranty fund required by that Law (R. 14, 25). The annual reports of the State Superintendent of Insurance, of which it is agreed the Court may take judicial notice (R. 14, 32), show that its accounts have been audited and published regularly as those of an insurance company, ever since its incorporation. Counsel for the petitioner makes no claim that the business done by the respondent was not expressly authorized by the New York Insurance Law.

It is, therefore, established that for nearly thirty years prior to the passage of the Revenue Act of 1921, the respondent had been specifically classed as an insurance company and known as such under the laws of the State of New York.

SECOND.

Mortgage insurance is recognized branch of insurance.

I. Not only in New York, but in other States, mortgage insurance is a well recognized form of insurance. In *The People* v. *Potts,* 264 Ill. 522, where the question at issue was whether a corporation about to be organized for the purpose of guaranteeing mortgages should be incorporated as a casualty insurance company or as a guaranty insurance company, the Court after an extended discussion of the subject said (p. 527):

> "Manifestly, under these authorities the purposes for which the relators desire to incorporate might be classed either as guaranty insurance or casualty insurance. An examination of the insurance laws of the various States authorizing the incorporation of companies shows that in some States the class of insurance business proposed to be done by relators may be carried on by guaranty insurance companies, in others by casualty insurance companies, and in still others by either class of companies. In this State companies incorporated under different acts can do, in part, the same kind of business. Under whatever name they are known such contracts are regarded as insurance contracts, and, as such, subject to the rules of construction applicable to insurance policies generally, and not to the rules applied to ordinary guaranty or surety contracts for accommodation. *United States Fidelity Co.* v. *First Nat. Bank,* 233 Ill. 475; Frost on Guaranty Insurance, (2d ed.) sec. 3. * * *"

(p. 528.) "No authority called to our attention would prevent classifying under the term 'guar-

anty insurance' the guaranteeing of loss for the non-payment of notes or other contracts of like nature."

II. The attempt made in the Government's brief to draw a fine-spun distinction between insurance and guaranty is quite beside the point in the present case.

In the first place, where the insurance relates to the payment of a sum of money only, as in mortgage insurance, no hard and fast line can be drawn. Frost, on Law of Guaranty Insurance (2d ed.), traces in his introduction the history of guaranty insurance and states (p. 16):

> "There is no hard and fast line to be drawn between contracts of insurance and contracts of guaranty."

For further discussion of what constitutes insurance, see

The People v. *Rose,* 174 Ill. 310;
Note to 47 L. R. A. (N. S.) 290;
Note to 63 A. L. R. 711;
Aetna Casualty & Surety Co. v. *Commercial State Bank,* 13 F. (2d) 474;
Tebbets v. *Mercantile Credit Guarantee Co.,* 73 Fed. 95;
Hunt v. *New Hampshire Fire Underwriters' Ass'n,* 68 N. H. 305.

In *Hunt* v. *New Hampshire Fire Underwriters' Ass'n* (*supra*), quoted in Words & Phrases (Vol. 4, p. 3676), the Court said:

> "An insurance contract is a contract of indemnity. It does not differ from a bond of indem-

nity or a guaranty of a debt, since the obligor or guarantor takes upon himself certain risks to which the obligee or creditor would otherwise be exposed. The only difference is in name and form of the instrument, the consideration for an insurance being always called a 'premium', and the instrument containing the terms of the contract a 'policy'."

III. Even if any such hypertechnical distinction could be drawn, it is impossible to attribute to Congress any intention to draw such distinction. In using the term, "insurance company", without defining it, Congress must either have intended to refer to insurance companies recognized as such under State laws, or, in any event, to companies doing a business commonly recognized as insurance. The stipulation and findings show that the terms, "insure", "policy" and "premium", were commonly used in respondent's business (R. 10-12, 21-23).

Conclusive proof that mortgage insurance was an established and well recognized form of insurance is found in the two Revenue Acts immediately preceding the Revenue Act of 1921. As will be shown under the next point, those Acts specifically included *"mortgage guarantee policies"* as policies of insurance and taxed them as such.

IV. The position of the Government on the question has been constantly shifting.

1. In denying the claims for refund, the Treasury Department conceded that all the respondent's premium income from guaranteeing mortgages was income from "straight insurance business" (Ex-

hibit W, R. 64). Based upon respondent's income from lending fees and statements in its advertising matter, the theory was eventually evolved that such insurance business was only incidental to an investment business (Exhibit M, R. 35-39). In an endeavor to support that theory, the Department stated, with disregard of the facts, that the respondent "does no guaranty or insurance business for others but confines its activities in this respect to its own investment securities. * * * In other words, it insures the investment securities which it offers to the public. The insurance feature merely serves to make the investments more attractive" (R. 38-39).

2. In the District Court, as the opinion shows (R. 15, 17), the Government conceded that the respondent's guaranties of mortgages which it had never owned were pure insurance business; but the argument was made that such guaranties, when given in connection with mortgages sold by the respondent, were not insurance.

3. Before the Circuit Court of Appeals, the Government contended that none of the respondent's business was insurance; in other words, it denied the existence of mortgage insurance as such (R. 71).

4. In this Court, the Government's brief avoids any direct statement on the subject, ignoring the insurance of mortgages for others and admitting that whether the guaranties in connection with sales should be considered insurance "is a matter of considerable doubt" (Petitioner's Brief, pp. 28, 23-31).

THIRD.

The statute and its history.

I. *Prior statutes.*

As just pointed out, the war taxes imposed by the two preceding Revenue Acts of 1917 and 1918 included taxes on insurance. The provisions of both Acts were similar; and for the purpose of this discussion, only the provisions of the Revenue Act of 1918 will be cited. The taxes were imposed by Section 503, insurance being classified under the three general groups of (a) life insurance, (b) fire and marine insurance, and (c) casualty insurance, including all other branches. The tax on the latter was at the rate of 1 cent for each dollar of premium.

The Act also imposed a stamp tax on "Bonds, indemnity and surety" (Title XI, Schedule A, subd. 2); and the tax on casualty insurance (Sec. 503, c) expressly excepted "bonds and policies taxable under subdivision 2 of Schedule A of Title XI".

The tax on bonds imposed by subdivision 2 of Schedule A of Title XI was a flat tax of fifty cents on various surety and indemnity bonds "and on all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortgage guarantee policies * * *. *Provided*, That where a premium is charged for the issuance, execution, renewal or continuance of such bond the tax shall be 1 cent on each dollar or fractional part thereof of the premium charged". The material parts of those sections are printed in full as Appendix B of this brief (*infra*, pp. 40-41).

Here, then, was an express classification of *"mortgage guarantee policies"* with other policies of insurance, as

distinguished from ordinary guaranties, and a tax imposed upon them at the casualty insurance rate of one cent for each dollar of premium. As the stipulation and findings show, the Treasury Department ruled that policies in the form of respondent's Exhibit T and Exhibit U should be taxed at the premium rates on the aggregate premiums, instead of the flat tax of fifty cents imposed on ordinary surety or guaranty bonds, and the respondent and other companies duly paid stamp taxes in accordance with such ruling (R. 14, 24). That is, on a policy insuring a five year mortgage for $100,000, instead of the flat tax of fifty cents imposed on indemnity and surety bonds, the tax was $25, computed at one cent per $1 of premium on premiums aggregating $2,500 (*i. e.*, five years' premiums at ½ of 1%, or $500, per year), and payable at once, whether the premiums were subsequently collected or not.

The mortgage insurance policies issued by the respondent and other companies having thus been expressly described as insurance and taxed as insurance under the two Revenue Acts immediately preceding the Revenue Act of 1921, how can the Government now claim with any semblance of plausibility that the policies issued by the respondent were not insurance policies in the recognized meaning of that term and that the words "every insurance company (other than a life or mutual insurance company)" in the Revenue Act of 1921 should be construed to exclude the respondent doing exclusively such mortgage insurance business?

Counsel for the petitioner make no attempt to meet that argument in their brief, although the 1918 Act is casually cited at pages 20-21, presumably to forestall any charge that it had been overlooked.

II. *Taxation of insurance companies in Revenue Act of 1921.*

The Revenue Act of 1921 repealed the tax on insurance (Sec. 1400-a) and also omitted the tax on surety and indemnity bonds (and mortgage guaranty policies) imposed by subdivision 2 of Schedule A, Title XI. As already explained, insurance companies were placed in a special class for income taxation (Secs. 242-247) and were exempted from capital stock tax (Sec. 1000, b).

The bill as originally introduced contained special provisions applicable only to life insurance companies. The Ways and Means Committee of the House, in reporting the original bill, stated:[1]

> "The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. * * * The new tax would yield a larger revenue than the taxes which it is proposed to replace."

A similar statement was made by the Senate Finance Committee, in reporting the bill to the Senate.[2] Prior to its enactment, the special classification was extended to all insurance companies, Sections 242-245 applying to "every life insurance company" and Sections 246-247 applying to "every insurance company (other than a life or mutual insurance company)". Those words show beyond any question the intention to include in the special classification *every* insurance company (except mutual insurance companies other than life, as to which

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1 67th Congress, 1st Session, Report No. 350, p. 14.
2 67th Congress, 1st Session, Senate Report No. 275, p. 20.

special provisions were inserted in the sections applicable to business corporations, *e. g.*, Sec. 234, a. 10-13, incl.).

III. *Purpose of special classification.*

Counsel for the Government offer no logical explanation of this special classification of insurance companies; but it is submitted that the obvious intention of the statute was to prevent litigation by requiring their income tax returns to be made in accordance with their annual reports to State Insurance Departments, as the references in Section 246 to the "annual statement approved by the National Convention of Insurance Commissioners" show.

Insurance companies are subject to State supervision and are required to keep their accounts in the manner prescribed by the various State Insurance Departments. Such accounting differs materially from the accounting rules applicable to ordinary business corporations. For example, the premiums received by an insurance company (whether for life insurance, fire insurance, or mortgage insurance) are its compensation for assuming a risk which ordinarily lasts for several years and which may require the payment of a loss far exceeding the total premiums collected on the policy. Under the ordinary rules of law and accounting applicable to business corporations, it is doubtful whether any part of such premium could lawfully be taxed as income in a given year, prior to the termination of the risk; but under the accounting system prescribed by State Insurance Departments and followed by insurance companies, the annual income from premiums is determined under special rules of accounting, with special reserves required. Since the passage of the original Excise Tax

Act of 1909, many cases have come before this Court involving the difficulty of determining the taxable income of insurance companies, under their distinctive methods of accounting, *e. g.*

McCoach v. *Insurance Co. of N. Amer.*, 244 U. S. 585;
Maryland Casualty Co. v. *United States*, 251 U. S. 342;
United States v. *Boston Insurance Co.*, 269 U. S. 197;
New York Ins. Co. v. *Edwards*, 271 U. S. 109.

IV. *Directions for computing net income.*

Section 246 based the computation of the net income of insurance companies, other than life and mutual companies, on the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. The National Convention of Insurance Commissioners is, of course, the National Convention of the Insurance Commissioners of the various States; and if this Court can and will take judicial notice of the annual statements approved by the Convention, as the statute seems to require, it will find that separate forms (commonly called "Convention Edition" forms and used by insurance companies in making their annual reports to the State Departments of Insurance) had been approved for (a) life insurance companies, (b) fire and marine insurance companies, and (c) miscellaneous insurance companies. The approved forms, therefore, covered the same three general classes of insurance which had been recognized and taxed in the two preceding Revenue Acts; and they were obviously

intended to cover all varieties of insurance companies—a clear indication that Section 246 was intended to apply to every insurance company (other than a life or mutual insurance company) filing annual reports with State Insurance Departments.

By far the largest single group of insurance companies falling within the provisions of Section 246 consisted of course of fire and marine insurance companies; and the detailed directions in Subdivision (b) of Section 246 for computing net income were naturally designed primarily for them. The provisions for computing underwriting income from premiums and, in general, the other provisions of the Section, corresponded with the accounting methods required in the Convention Edition for fire and marine insurance companies—another clear indication that the purpose of the statute was to require the income tax returns of insurance companies under Section 246 to be prepared in accordance with their annual statements to the State Insurance Departments.

Those provisions are not directly involved on the present appeal; but the Government has argued at various times that, since fees were not expressly mentioned in subdivision (b), the respondent and other mortgage insurance companies would escape taxation on their lending and extension fees, if they were held to be insurance companies within the meaning of Section 246. The argument is made in this Court only by suggestion. It is conceded that the respondent has never made any such contention (Petitioner's Brief, p. 39); and the record shows that the respondent voluntarily reported such fees as income in its returns for 1921, 1922 and 1923 (R. 9, 20), though its return for 1923 was not filed until March 15, 1924 (*id.*), several months after its

claims for refund of capital stock tax, which were filed in November, 1923 (R. 8-9, 19-20).

The suggestion that such fees would escape income tax is a transparent argument *in terrorem*. The Convention Edition for miscellaneous companies in use in 1921 contained in the income exhibit special items for "Policy fees required or represented by applications", and for "Inspections", and also income from miscellaneous sources; and the same items were repeated in the underwriting and investment exhibit, so that there can be no claim that such fees were not shown in the annual statement for miscellaneous companies. In New York, the State Insurance Department had provided a special form for Title and Mortgage Guaranty companies organized under Section 170, Article V. of the Insurance Law, so that such insurance companies did not use the Convention Edition for their annual reports. Copies of the respondent's reports on such forms for 1921 and 1922 were admitted in evidence (Exhibits D and E, R. 8, 19), showing such fees as income; and it is not disputed that the respondent's income tax returns were prepared in accordance with those reports, including such fees. The Board of Tax Appeals has also held that income tax returns under Section 246 should be prepared on the basis of the annual statement, and that fees, of a somewhat different nature, should be included as income in a return made by an insurance company under Section 246.

> *Massachusetts Protective Association, Inc.* v. *Commissioner*, 18 B. T. A. 810, 816; Acq. X-1C B 41.

In addition, if the respondent, or any other mortgage insurance company, should ever claim that such

fees were excluded from gross income under the literal wording of Section 246, they would undoubtedly be met by the argument, not only that the statute required their income tax returns to be prepared in accordance with their annual statements, but also that such fees, if they exceeded the actual expenses of inspection and appraisal, were equivalent to additional interest and so were within the literal language of the statute requiring interest income to be reported.

FOURTH.

Section 246 must be construed to apply to insurance companies incorporated as such under State law.

I. As demonstrated under the preceding point, the term, "every insurance company (other than a life or mutual insurance company)", was obviously intended to include every insurance company recognized as such by State laws; and that may well have been the reason why there was no definition of the term.

That construction is the only one which will give any rational or orderly interpretation of the statute, as a whole. It is inconceivable that Congress intended to include in the classification of insurance companies any corporation not organized as an insurance company under State laws; and it is almost equally inconceivable that Congress intended to require, or permit, the Treasury Department to examine into the business of every State insurance company filing income tax returns in accordance with its annual statements to State Insurance Departments and arbitrarily to refuse to recognize as an insurance company any company having income which the Department considered was not income from purely insurance business. The business and income of every corporation fluctuate; and insurance companies concededly entitled to classification as such often receive incidental income from allied activities.

In passing upon another case, the Solicitor of Internal Revenue ruled that a title insurance company incorporated in New York under Section 170 of the Insurance Law was entitled to classification as an insur-

ance company under Section 246 (of the Revenue Act of 1924), despite incidental income from fees, saying:

> "In view of all the foregoing, it is apparent that the income of the M Company is derived from the issuance of contracts of insurance and sources fairly incidental to what is an insurance business. It is true that a substantial part of the income of this company is derived from fees for searching and examining titles, not strictly insurance functions, yet it appears that these examinations are made solely as preliminary steps to the issuance of insurance contracts. This office is, therefore, of the opinion that a corporation so organized and operated is an insurance company within the meaning of section 246 of the Revenue Act of 1924 and entitled to file returns as an insurance company thereunder" (S. M. 5501, Cumulative Bulletin V-1 [June, 1926], 102, at p. 104).

The same language is applicable to the present case; for the respondent's lending and extension fees, covering its appraisals and inspections, were clearly incidental and preliminary steps to the sale of the mortgages and the issuance of its mortgage insurance. As pointed out in detail later (*infra*, p. 26), the annual reports of the New York State Superintendent of Insurance, of which it was stipulated that the Court might take judicial notice (R. 14), show the fluctuations of such incidental income of insurance companies in New York State, alone. In the respondent's own case, its income from fees in 1918 was only $89,821, out of a gross income of over $1,000,000 (R. 36). If the right to classification as an insurance company were made to depend upon the size of such incidental income, then

under any arbitrary rule which the Government might attempt to establish, the status of many corporations would inevitably change from year to year—a result which it is impossible to believe Congress had in mind.

II. Moreover, any such arbitrary classification would have resulted in chaos, when applied to the capital stock tax. That tax, as explained at length in the Treasury Regulations, was prospective, payable in advance on a return due in July for the privilege of doing business during the Government fiscal year from July 1 to the following June 30 (Regs. 64, Arts. 2, 14, 20), whereas income taxes were assessed on the calendar year basis. Obviously, under any such arbitrary classification, no insurance company could possibly determine in advance in July, when capital stock tax returns were due, whether or not its business for the remaining six months of that calendar year and the first six months of the following calendar year would result in its being classed as an insurance company for income tax purposes for either or both calendar years; and, as just pointed out, under any such arbitrary classification, its status for income tax purposes might not be the same in the two calendar years.

III. For all those reasons, the term, "every insurance company", in Section 246 must obviously be construed as meaning insurance companies recognized as such under State laws; and that construction is not only sanctioned but directly required under the decision of this Court in *United States* v. *Loan & Bldg. Co.*, 278 U. S. 55, discussed under a separate point later in this brief (*infra*, pp. 30-32).

FIFTH.

Government's contentions answered.

I. The substance of the Government's argument is, that the respondent was engaged in a mortgage investment business quite distinct from that of an insurance company and which prevents it from being classed as an insurance company, in the ordinary meaning of that term. At the outset of the Government's brief, stress is laid upon the fact that the respondent described its business as "Guaranteed Mortgages" in its tax returns. As will be explained later, that description was not inconsistent with its right to be classed as an insurance company; and the statement that the respondent did not claim to be an insurance company in its income tax returns (Brief, p. 3) is hardly supported by the record. During 1921, 1922 and 1923, the same form of income tax return was used by both ordinary business corporations and insurance companies. The respondent made its returns on that form, in accordance with its annual statements to the New York Insurance Department, which, as already pointed out, was the basis prescribed for insurance companies by Section 246.

II. As to the nature of the respondent's business, the argument in the Government's brief entirely ignores the insurance for others of mortgages which the respondent never owned, which was conceded in the District Court to be purely insurance business (R. 15, 17). Before the Circuit Court of Appeals, it was argued that even such business was not insurance (R. 71); but that contention was thoroughly rebutted by the opinions of the Circuit Court of Appeals. In this Court, the subject is ignored

in the Government's argument; but it is submitted that, beyond any question, this Court must recognize such business as insurance, for the reasons already stated.

If the guaranteeing of mortgages which the respondent never owned was insurance, then the guaranteeing of mortgages under the same form of policy for the same premium was equally insurance, regardless of the fact that the respondent had previously owned the mortgages. That was a development of the business expressly authorized, and undoubtedly contemplated by the amendments to the New York Insurance Law in 1911 and 1913.

III. Petitioner's brief stresses the fact that two corporations incorporated under the Banking Law of New York make mortgage loans and sell mortgages with their guaranty under the same general method of doing business as the respondent. It is quite true that investment companies organized under the Banking Law of the State of New York are authorized to deal in mortgages, as well as other forms of investment; but the business is one which can be done only by a moneyed corporation (*i. e.*, a corporation formed under the Banking Law or the Insurance Law).

Op. Att'y Gen. of New York (1893), page 182.

Such investment companies formed under the Banking Law cannot, of course, insure mortgages for others, which is still a substantial feature of respondent's business (R. 12, 23); and the fact that the sale of guaranteed mortgages is a business which may be engaged in only by moneyed corporations and not by ordinary business corporations certainly does not strengthen petitioner's claim that the respondent should be regarded as an ordinary business corporation. As against two corpora-

tions formed under the Banking Law, the annual report of the New York State Superintendent of Insurance for the year 1928 (the year before the stipulation was signed) shows that, of the forty-five title and mortgage guaranty companies incorporated in New York, at least thirty-one of them received premiums for mortgage guaranties (New York Insurance Report, 1929, Part III, pp. 719-813). The amounts ranged from $71.82, received by the Western New York Title and Guaranty Company, of Buffalo, out of a total gross income of $133,458.54 (*id.*, p. 812), to $3,292,164.16, received by the Bond and Mortgage Guarantee Company, of Brooklyn, out of a total gross income of $4,751,316.54 (*id.*, p. 725). Every one of the forty-five companies (except one not fully organized) received income from fees; and there were equally wide variations in the nature and relative size of the various fees collected. Many of the forty-five companies were engaged wholly or primarily in title insurance—a form of insurance unquestionably entitling them to be classed as insurance companies; and the figures show clearly how hopeless it would be to attempt to establish any logical or uniform rule barring any of them from classification as an insurance company. No claim is made by the Government that any such rule has ever been promulgated or even formulated.

It follows that the respondent's description of its business as "Guaranteed Mortgages" did not indicate in any way that the respondent was not an insurance company. On the contrary, it indicated a business done almost exclusively by insurance companies, in which ordinary business corporations were not permitted to engage; and it also called attention to the fact that the respondent did no title insurance business.

Moreover, the primary object of investment companies, as distinguished from insurance companies, is to make profits by selling securities at a higher price than the price paid for them; but it is conceded that the respondent makes no such profits on the sale of mortgages (R. 12, 23). Its principal income was from three sources, namely (R. 36):

(1) Lending and extension fees;

(2) Interest on mortgages and other securities; and

(3) Premiums.

(1) As to lending and extension fees, not only insurance companies, but individuals and corporations of all kinds, savings banks in particular, make mortgage loans and collect such fees. The size of such fees is determined by current rates and may or may not exceed the actual cost of appraisals and inspections. It certainly cannot be claimed that either the respondent or other lenders were making mortgage loans on account of the income to be derived from such fees; and it is conceded in the present case that the primary purpose of the respondent in making such loans was the sale of the mortgages, with its insurance (R. 12, 23).

(2) The purpose for which savings banks and other investors make mortgage loans is, of course, the interest income to be derived from holding them as investments; but aside from the securities which it was required to hold under the Insurance Law, that was not the respondent's purpose, since its purpose was to sell the mortgages, not to hold them for investment (R. 12, 23).

(3) It necessarily follows that the object of all the respondent's so-called "investment" business was the pre-

mium income derived from its insurance. The findings expressly show that, in assigning mortgages, the respondent *always* issues its policy, Exhibit T, or its certificate, Exhibit U (R. 12, 23). The advertising matter issued by the respondent in endeavoring to increase its sales of mortgages and hence its insurance obviously has no legal significance; and the statement quoted at page 23 of the Government's brief (that the sole business of the respondent was to supply conservative investors with first mortgages with principal and interest fully guaranteed by the respondent) was undoubtedly intended to call attention to the fact that the respondent did not engage in any other form of insurance (as many other insurance companies did), so that its entire assets were behind its policies of mortgage guaranty.

IV. It is submitted that, even if the Government might conceivably be justified in some exceptional cases in refusing to recognize State classification, no ground exists for disregarding it in the present case. The respondent's business was essentially insurance, from the time it was incorporated in 1893; and it was a business commonly and regularly done by insurance companies.

The numerous innuendoes in the petitioner's brief as to the effect that such classification might have on other cases and taxes do not require serious consideration. So far as income taxes are concerned, those innuendoes have already been shown to be without foundation (*supra*, pp. 18-20). The suggestion that stamp tax cases may also be affected (Petitioner's Brief, p. 20) is equally without foundation. In *Mortgage Guarantee Co.* v. *Welch*, 38 Fed. (2d) 184, cert. den. 281 U. S. 759, the Mortgage Guarantee Company had issued obligations with fixed

interest dates and rates, secured by several millions of dollars of mortgages deposited with a Trustee in a revolving fund. The decision that such obligations were subject to stamp tax as corporate securities did not depend in any way upon whether the Mortgage Guarantee Company was or was not entitled to classification as an insurance company under the Revenue Acts. Liability for stamp tax in that and other cases depends upon the form of the obligation, not upon the identity or classification of the corporation which issues it.

V. The entire argument made by the Government in the present case in attempting to avoid refund of capital stock taxes is exactly parallel to the argument made by the Government and rejected by this Court in the *Cambridge Loan and Building Company* case, which will now be considered.

SIXTH.

United States v. _Loan & Bldg. Co._, 278 U. S. 55, is controlling and conclusive.

In the case cited above, the question before the Court was whether the Cambridge Loan and Building Company, a building and loan association incorporated under the laws of the State of Ohio, was exempt from Federal income tax under Section 231 (4) of the Revenue Act of 1918 and the Revenue Act of 1921, exempting "Domestic building and loan associations * * *". The purpose of the exemption was undoubtedly to relieve from income tax associations formed to enable members to buy or build homes of their own; and the Government, having analyzed the business of the corporation and found that its principal business was making loans to, and receiving deposits from, persons not members, claimed that the company was in fact doing a banking business, and so should pay income tax like other corporations engaged in banking and was not entitled to exemption as a building and loan association. In other words, the Government claimed in that case, with much more justification, exactly what it is claiming in the present case, namely: the right to disregard State classification and the ordinary interpretation of terms in common use and substitute an analysis of the business done, under arbitrary standards of its own, in enforcing the Revenue Acts.

In holding that the Company was exempt, this Court said (p. 58):

> "Under the Ohio statute the respondent has these powers, and still, as we have said, is called a building and loan association by that State.

> The same name was commonly used in other States and similar powers were given with more or less restriction. When Congress exempted such associations from the income tax of course it was speaking of existing societies that commonly were known as such, not of ideals that would have been hard to find."

In answer to the argument that such associations might be used as a mask to escape taxation, the Court said (p. 59):

> "The present taxes are upheld by the Government on the ground that the respondent is such a mask. It is argued that even admitting all that has been said thus far, a State cannot make a bank exempt merely by calling it a building and loan association. No doubt extravagant cases might be imagined. But these associations are well known and a State is not likely to be party to a scheme to enable a private company to avoid federal taxation by giving it a false name. The statutes speak of 'domestic' associations, that is, associations sanctioned by the several States. They must be taken to accept, with the qualifications expressly stated, what the States are content to recognize, unless there is a gross misuse of the name. The State of Ohio has recognized and still recognizes the respondent as belonging to the class which its name indicates. Very possibly the company has strained its privileges to near the limit, but we are not prepared to condemn the nomenclature adopted by the State."

That language and argument (except the last sentence) apply exactly to the construction to be given the words, "insurance company", in Section 246 of the Revenue Act of 1921, now under consideration; and the

word "domestic" was also used in Section 246. Whatever may be said as to the nature of respondent's business in the present case, there can be no possible claim that its incorporation as an insurance company was a mask to escape taxation. It has been incorporated and engaged in business under the same State law for nearly thirty years prior to the passage of the Revenue Act of 1921. Paraphrasing Justice Holmes' language:

> "When Congress exempted insurance companies from capital stock tax, of course it was speaking of existing societies that commonly were known as such, not of ideals that would have been hard to find."

There were much stronger arguments in support of the Government's position in the *Cambridge Loan and Building Company* case than there are in the present case. Concededly, the *Loan and Building Company* was doing a banking business which building and loan associations were not ordinarily authorized to do and which was entirely foreign to the purpose for which they had been exempted from income tax. If the Company was classed as a building and loan association, it escaped income tax entirely, whereas corporations in the same and other States doing exactly the same class of business were subject to income tax as banking corporations.

In the present case, the respondent is not seeking to escape income tax. It was doing only the usual kind of mortgage insurance business which insurance companies in New York and other States had been doing for years, and which had been expressly taxed as insurance under the two preceding Revenue Acts. In addition, in the present case the statute showed clearly the intention to base the classification on State law.

SEVENTH.

Conclusion.

The question at issue is the construction of the term, "insurance company", as used in the Revenue Act of 1921.

I. The term was obviously intended to apply to insurance companies incorporated as such under State laws. That construction gives an intelligible and workable construction of the statute and is sanctioned, and directly required, by the decision of the Supreme Court in the *Cambridge Loan and Building Company* case.

II. If the State classification is not adopted, what is the alternative? A purely arbitrary classification by the Treasury Department, which would have resulted in confusion worse confounded, especially since capital stock taxes and income taxes were not imposed for the same fiscal periods.

III. Under any proper basis of classification, the respondent must be classed as an insurance company in any event. Having previously been taxed by Congress on its policies of mortgage guaranty as policies of insurance, so designated in the two preceding Revenue Acts, there can be no valid basis for excluding it from classification as an insurance company under the Revenue Act of 1921.

EIGHTH.

The judgment below should be affirmed.

January, 1932.

Respectfully submitted,

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Appendix A.

EXTRACTS FROM REVENUE ACT OF 1921.

Title X.—Special Taxes. *Capital Stock Tax.*

Sec. 1000. (a) That on and after July 1, 1922, in lieu of the tax imposed by Section 1000 of the Revenue Act of 1918——

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

* * * * * * * * *

(b) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or, in the case of a foreign corporation, not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in section 231, nor to any insurance company subject to the tax imposed by section 243 or 246.

FROM TITLE II—INCOME TAX.

Sec. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

* * * * * * * * *

Sec. 246. (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230;

(2) In the case of such a foreign insurance company the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by section 230.

(b) In the case of an insurance company subject to the tax imposed by this section——

(1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247;

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due

and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred.

(5) The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the results so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by section 247.

Sec. 247. (a) That in computing the net income of an insurance company subject to the tax imposed by section 246 there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in paragraph (1) of subdivision (a) of section 234;

(2) All interest as provided in paragraph (2) of subdivision (a) of section 234;

(3) Taxes as provided in paragraph (3) of subdivision (a) of section 234;

(4) Losses incurred;

(5) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(6) The amount received as dividends from corporations as provided in paragraph (6) of subdivision (a) of section 234;

(7) The amount of interest earned during the taxable year which under paragraph (4) of subdivision (b)

of section 213 is exempt from taxation under this title, and the amount of interest allowed as a credit under subdivision (a) of section 236;

(8) A reasonable allowance, for the exhaustion, wear and tear of property, as provided in paragraph (7) of subdivision (a) of section 234:

(9) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 246 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in subdivision (b) of section 234.

(c) Nothing in this section or in section 246 shall be construed to permit the same item to be twice deducted.

Appendix B.

Extracts From Revenue Act of 1918.

Sec. 503. That from and after April 1, 1919, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 504 of the Revenue Act of 1917, the following taxes on the issuance of insurance policies, including, in the case of policies issued outside the United States (except those taxable under subdivision 15 of Schedule A of Title XI), their delivery within the United States by any agent or broker, whether acting for the insurer or the insured; such taxes to be paid by the insurer, or by such agent or broker:

(a) Life insurance: * * *

(b) Marine, inland and fire insurance: * * *

(c) Casualty insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or obligation of the nature of indemnity for loss, damage, or liability (except bonds and policies taxable under subdivision 2 of schedule A of Title XI) issued or executed or renewed by any person transacting the business of employer's liability, workmen's compensation, accident, health, tornado, plate glass, steam boiler, elevator, burglary, automatic sprinkler, automobile, or other branch of insurance (except life insurance, and insurance described and taxed in the preceding subdivision): *Provided,* That in case of policies of insurance issued on the industrial or weekly or monthly payment plan the tax shall be 40 percentum of the amount of the first weekly premium or 20 per centum of the amount of the first monthly premium, as the case may be.

TITLE XI, SCHEDULE A, SUBDIVISION 2.

2. Bonds, indemnity and surety: On all bonds executed for indemnifying any person who shall have become bound or engaged as surety, and on all bonds executed for the due execution or performance of any contract, obligation or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and on all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortgage guarantee policies, and on all other bonds of any description, made, issued, or executed, not otherwise provided for in this schedule, except such as may be required in legal proceedings, 50 cents: *Provided,* That where a premium is charged for the issuance, execution, renewal or continuance of such bond the tax shall be 1 cent on each dollar or fractional part thereof of the premium charged: *Provided further,* That policies of reinsurance shall be exempt from the tax imposed by this subdivision.